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No. 81-79

IN THE

Supreme Court of the United States

October Term, 1981

IN RE STATE OF MISSOURI, et al.,

Petitioners,

—v.—

UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF ARKANSAS and the HONORABLE CHARLES W. BAKER, et al.,

Respondents.

PETITIONERS' SUPPLEMENTAL BRIEF IN SUPPORT OF THEIR PETITION FOR A WRIT OF CERTIORARI FROM FINAL JUDGMENT ENTERED BY THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

Dated: August 12, 1981

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QUESTIONS PRESENTED BY THIS SUPPLEMENTAL BRIEF

1. Does a bankruptcy court have subject matter jurisdiction to bar a state from enforcing, as against a grain warehouseman's bankruptcy trustee, the state's grain laws regulating grain warehousing, on the theory that the general exemption from bankruptcy court jurisdiction of governmental actions to enforce police and regulatory power does not apply to state grain laws because they relate primarily to the protection of the pecuniary interests of the grain owners?

2. Can 28 U.S.C. § 1471 be construed to confer subject matter jurisdiction on a bankruptcy court (a) to preclude the exercise of a state's police and regulatory power over grain deposited for storage with a debtor-warehouseman prior to its bankruptcy in which the debtor has no proprietary or other material economic interest except for possession as a mere bailee, or (b) to bar a sovereign state from enforcing its grain laws in state courts against bankruptcy trustees, where enforcement would not impact adversely against any bankruptcy law policy?

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This supplemental brief is submitted on behalf of the State of Missouri, et al., Petitioners herein, in support of their Petition, filed on July 8, 1981, requesting that this Court issue a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit entered on April 8, 1981.* In its opinion, now reported in 647 F.2d 768, the Eighth

* Confronted with Respondents' threats of contempt sanctions for Petitioners' good faith actions as government officials, and to avert confrontation between the United States Marshalls and barricading farmers, Appendix, p. A-5, Petitioners sought a writ of prohibition to confine the bankruptcy court to its lawful jurisdiciton. *Ex Parte Republic of Peru,* 318 U.S. 578, 586 (1943); *In re Attorney General of United States,* 596 F.2d 58, 63-64 (2d Cir.), *cert. denied,* 444 U.S. 903 (1979).

Circuit held that the bankruptcy court had jurisdiction over grain deposited for storage with, although *not* owned by, the debtors and that Petitioners were thus barred from enforcing state grain laws as against the bankruptcy trustee of state-regulated warehouse companies that only had a "minute" ownership interest in grain held for storage. Appendix, p. A-11. State enforcement was precluded because the grain laws protected pecuniary interests. Appendix, pp. A-13 to A-15.

Since the filing of the Petition on July 8, 1981, Petitioners learned that the decision below is in basic conflict with recent decisions of both the Second and Fifth Circuits.* Those decisions correctly ruled that governmental units are not disabled from enforcing their police and regulatory power against a debtor or trustee in bankruptcy even though a primary object of such governmental action is to protect the pecuniary interests of the protected class (i.e., the investing public, consumers, or other group within the zone of protection of the non-bankruptcy statute).

The Court of Appeals has held in this case that the jurisdiction of the bankruptcy courts,** as established by 28 U.S.C. § 1471, is so pervasive as to preclude enforcement by Missouri of its grain laws which, like those of 26 other states,*** were enacted in the exercise of its police and regulatory powers to prevent practices injurious to the integrity of the grain industry. Reconciliation of the scope of the jurisdiction of the bankruptcy courts with the jurisdiction of state courts to

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* The Second Circuit's decision in *Commodity Futures Trading Commission* v. *Incomco, Inc.*, 649 F.2d 128 (2d Cir. 1981) was published on July 20, 1981 and the Fifth Circuit's decision in *Securities and Exchange Commission* v. *First Financial Group of Texas*, 645 F.2d 429 (5th Cir. 1981), shortly before.

** The bankruptcy courts were created in 1978 by 28 U.S.C. § 151.

*** Grain laws are in force in the following states:

Alabama, Arkansas, Colorado, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Minnesota, Mississippi, Missouri, Montana, Nebraska, North Carolina, Ohio, Oregon, South Carolina, South Dakota, Texas, Utah, Virginia, Washington, Wisconsin and Wyoming.

entertain governmental proceedings to enforce grain laws, is important to the agriculture industry and the free flow of commerce in grain.* This Court has often granted certiorari to review significant questions involving federal-state relations. *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *David Ware et al.*, 414 U.S. 117, 119 (1973).**

I. Circuit conflict

By its decision below, the Eighth Circuit held that the express limitation in the bankruptcy law withholding from bankruptcy courts the power to bar enforcement proceedings by governmental units in non-bankruptcy courts, does not apply where the laws to be enforced "primarily relate to the protection of the pecuniary interest in the debtors' property and not to matters of public health and safety." Appendix, p. A-15.

The Eighth Circuit's decision is in basic conflict with the decisions of the Second Circuit in *Commodity Futures Trading Commission* v. *Incomco, Inc., supra.*, 649 F.2d 128 and of the Fifth Circuit in *Securities and Exchange Commission* v. *First Financial Group of Texas, supra*, 645 F.2d 429. These recent decisions in two other Circuits correctly hold that the 1978 bankruptcy legislation has not stripped governmental units of their traditional power to enforce non-bankruptcy laws in non-bankruptcy courts simply because the regulatory goal involves protection of pecuniary interests.

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* Review by this Court is also important in light of another development since the Petition was filed on July 8, 1981: an opinion dated July 24, 1981 in *Marathon Pipeline Company* v. *Northern Pipeline Construction Co.*, Civil 4-80-589, D. Minn., held that 28 U.S.C. § 1471 was an unconstitutional delegation of judicial power to the bankruptcy courts. A direct appeal to this Court has been filed.

** As recently noted by Mr. Justice Rehnquist in his dissenting opinion in *New Jersey* v. *Reading Company, Debtor in Possession*, ____ U.S. ____, 68 L.Ed.2d 310 (1981), few bankruptcy cases have been recently decided on the merits by this Court, unlike cases involving various other more popular legal subjects. The present case, however, poses important issues of bankruptcy law, federal court jurisdiction, constitutional law, and federal-state relations.

In *Commodity Futures Trading Commission* v. *Incomco, Inc.*, the Court ruled that the pendency of a bankruptcy case concerning a debtor company engaged in the commodity futures trading business did not preclude the granting of an injunction to the Commodity Futures Trading Commission in a non-bankruptcy plenary action it filed against the debtor company.* Similarly, the grant of equitable relief to the Securities and Exchange Commission for the protection of the financial interests of the "investing public" was sustained in *Securities and Exchange Commission* v. *First Financial Group of Texas, supra*, 645 F.2d at 438. The Fifth Circuit there upheld the district court's appointment of a temporary receiver for a securities dealer "[i]n order to protect the public welfare—and especially the interests of those who invested with [the debtor]—" 645 F.2d at 439.**

State enforcement actions designed to protect pecuniary interests have been withdrawn by the Eighth Circuit from the scope of the general principle immunizing governmental enforcement proceedings from bankruptcy court jurisdiction. Its decision engrafts an exception as to pecuniary interests onto the jurisdictional statute that is without support in the language of the 1978 bankruptcy legislation, its Congressional history or bankruptcy law policy. It also erroneously characterized grain laws as primarily protecting pecunicary interests. The Court's rationale failed to recognize that state grain laws comprehensively regulate the grain industry to assure the integrity of grain markets. Petitioners' legal and societal interests in enforcing their grain laws thus transcend the pecuniary interest of the grain owners. Nor should the goal of state

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* Even though the relevant non-bankruptcy law had as its objective the protection of the pecuniary interests of the investing public, the Commission's suit to enforce its police power was exempt from the automatic stay of the Bankruptcy Code. 649 F.2d at 133.

** It has also been recently held that the jurisdiction of the bankruptcy courts does not to extend to the National Labor Relations Board, which deals principally with *pecuniary* relations between employers and employees. *National Labor Relations Board* v. *Evans Plumbing Company*, 639 F.2d 291 (5th Cir. 1981).

grain laws be subordinated to the purely pecuniary, non-constitutional, right of warehouse operators to seek bankruptcy relief. *United States* v. *Kras*, 409 U.S. 434, 437 (1973).

Certain provisions in the 1978 bankruptcy legislation explicitly *withheld* jurisdiction from the bankruptcy courts to bar enforcement by governmental units of their police and regulatory powers in non-bankruptcy courts. 28 U.S.C. § 1478 and Bankruptcy Code §§ 362(b)(4) and 362(b)(5).* The House Judiciary Committee's report relating to the 1978 bankruptcy legislation establishes that governmental units were intended to retain their power to enforce their laws designed to afford "consumer protection" as well as those designed to guard against "fraud" and to provide protection under "similar police or regulatory laws." H. Rep. 95-595, p. 343. These categories included a variety of governmental proceedings involving protection of pecuniary interests. These conclusions are not affected by a statement by one Congressman, relied on by the Court below, that the immunity of governmental units from bankruptcy court jurisdiction does not extend to actions to protect a pecuniary interest in property of the debtor or the estate. Appendix, p. A-14. That statement related only to property owned by the debtor or the estate; in this case only a "minute" portion of the grain was so owned. Appendix, p. A-11. Further, as stated by this Court: "The remarks of a single legislator, even the sponsor, are not controlling in analyzing legislative history." *Chrysler Corporation* v. *Brown*, 441 U.S. 281 at 311 (1979). Accord, *Duplex Printing Press Company* v. *Deering*, 254 U.S. 460, 474 (1921); *Zuber* v. *Allen*, 396 U.S. 168, 186 (1969). In accordance with the Judiciary Committee's intent not to enable a government to enforce a money judgment against a bankrupt, H. Rep. 95-595, p. 343, this statement explained that a government unit's *own* pecuniary rights could not be enforced against property of the debtor or the

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* The endorsement by the 1978 bankruptcy legislation of governmental power to enforce non-bankruptcy laws in non-bankruptcy courts was a re-enactment of a time-honored principle. *Palmer* v. *Commonwealth of Massachusetts*, 308 U.S. 79 (1939); *In re Teltronics*, 649 F.2d 1236 (7th Cir. 1981).

estate. The statement also was at variance with the much broader exemption for governmental units contemplated by the full Committee. H. Rep. No. 95-595, p. 343.

Review by this Court is necessary to resolve the conflict in the Circuits and to provide guidance both to the bankruptcy courts and governmental officials.*

II. 28 U.S.C. § 1471 was misconstrued below

Review of the decision below is also necessary for the reason that 28 U.S.C. § 1471 was broadly construed by the Court of Appeals in a fashion not warranted by the basic objectives of the bankruptcy laws** and the jurisdiction of the bankruptcy courts should not have been expanded by implication.*** The Court also engrafted on Bankruptcy Code § 541 (dealing with "property of the estate") subject matter jurisdictional consequences that should not be attached to a substantive bankruptcy law. This consequent enlargement of the jurisdiction of the bankruptcy courts is likely to create confusion among bankruptcy judges throughout the nation as to the lawful scope of their power.

The Eighth Circuit's construction of 28 U.S.C. § 1471 erroneously expanded the jurisdiction of the bankruptcy courts:

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* The Eighth Circuit's decision crippling state enforcement of grain statutes has begun to have broader impact. *In re Joe De Lisi Fruit Co.*, CCH Bankr. L. Rep. dated July 16, 1981, ¶ 68,082 (sustaining a stay against the Minnesota Department of Agriculture on the theory that its action was to protect creditors).

** 28 U.S. § 1471 should be construed according to the purposes of bankruptcy legislation as a whole. *Reading Company* v. *Brown*, 391 U.S. 471, at 475 (1968); *Kokoszka* v. *Belford*, 417 U.S. 642, 645-46 (1974). Its basic purposes are two-fold: to enable distribution to the creditors, and to provide the debtor with a fresh start. *Burlingham* v. *Crouse*, 228 U.S. 459 (1913).

*** The bankruptcy courts, as federal courts of limited jurisdiction, *Aldinger* v. *Howard*, 427 U.S. 1, 15 (1976), do not have implied power to bar law enforcement actions in other courts. Further, 28 U.S.C. § 1481 expressly withholds such power.

1. The Court below ruled that "the grain here in question is 'property of the estate' *for jurisdictional purposes*." (Italics added). Appendix, p. A-19. That interpretation of 28 U.S.C. § 1471(e) by the lower court compounds the quandary as to the jurisdiction of the bankruptcy courts because it reads 28 U.S.C. § 1471(e) interchangeably with Bankruptcy Code § 541, a non-jurisdictional provision. 28 U.S.C. § 1471(e) purports to grant exclusive jurisdiction to the bankruptcy courts over the property "of the debtor". By contrast, the Bankruptcy Code, in § 541, defines property of the "estate", not of the "debtor". That distinction was made by this Court in *Reading Company* v. *Brown*, *supra*, 391 U.S. at 481. The lower court, however, both failed to recognize that distinction and confused a substantive bankruptcy concept under § 541 (the "estate") with subject matter jurisdiction under 28 U.S.C. § 1471(e), i.e. "property of the debtor". Under the 1978 bankruptcy legislation, jurisdiction of the bankruptcy courts based on property is predicated solely on the debtor's property, not the estate's. However, the Court below based it on purported property of the estate. It treated as property of the "estate" grain in which the debtors never had any ownership interest, and on that predicate concluded that the estate had a property interest for jurisdictional purposes. This ignored the language of 28 U.S.C. § 1471(e).

2. Property that is not owned by a debtor cannot be property of the estate "for jurisdictional purposes". In this case, the debtors and the trustee had a "minute ownership interest" of only 2.3%. Appendix, p. A-11. The Eighth Circuit apparently considered the trustee's "minute" ownership (2.3%) in the grain as sufficient to change the quality of the debtors' *possessory* interest as a mere *bailee* in the remainder (97.7%) into a real ownership interest of the debtors sufficient to trigger jurisdiction in the bankruptcy court over all ownership and other questions. That analysis was a fiction. A bailee's interest simply is not sufficient to constitute ownership in property, for a bailee has no alienable interest. *Segal* v. *Rochelle*, 382 U.S. 375, 379 (1966); 73 *C.J.S.*, *Property*, § 13, at p. 193; *Collier* v.

California Co., 73 F. Supp. 413, 415 (W.D. La. 1947).* The lower court nevertheless found that the debtors' estates had interests in the grain "sufficient to trigger preliminary jurisdiction," and ruled that this grain was "property of the estates 'for jurisdictional purposes' ". Appendix, p. A-19. Nothing in 28 U.S.C. § 1471 or in bankruptcy laws suggests a concept of "preliminary jurisdiction" or jurisdiction on the basis of something that is *not* property of the debtor.

3. The construction of the pertinent sections of the 1978 bankruptcy legislation by the Court below raises the spectre of unconstitutionality. Petitioners assert a right under the Eleventh Amendment to the Constitution to be immune from proceedings against them in the bankruptcy court designed to bar their enforcement of the Missouri grain laws in the state courts. *Employees of the Department of Public Health & Welfare* v. *Department of Public Health & Welfare*, 411 U.S. 279 (1973); *State of Tennessee* v. *Taylor*, 169 F.2d 626 (6th Cir. 1948). 28 U.S.C. § 1471 should not be construed so as to enable the filing of suits against the State of Missouri in a federal bankruptcy court. This Court has often applied the canon of construction that when a statute is ambiguous, it should be construed in a way that will "comport with constitutional limitations" and go "in the direction of constitutional policy". *Regional Rail Reorganization Act Cases*, 419 U.S. 102, at 134 (1972).

4. More light is shed on 28 U.S.C. § 1471 by contrasting it with 28 U.S.C. § 1478 and Bankruptcy Code §§ 362(b)(4) and 362(b)(5), which expressly withhold from bankruptcy courts jurisdiction over governmental actions to enforce their police and regulatory power against a debtor. Bankruptcy court jurisdiction should not have been expanded by implication to bar state enforcement proceedings, particularly where to do so would tend to vest in them jurisdiction to adjudicate unsettled

* It is fundamental that under the bailment contracts covering grain, title does not pass to a trustee in bankruptcy. *In re Wright-Dana Hardware Company*, 211 Fed. 908 (2d Cir. 1914). The 1978 bankruptcy legislation preserved the principle that where the debtor's interest in property is limited, it is no greater in the hands of the trustee. H. Rep. 95-595, p. 368.

questions of state law arising under state statutes. *Thompson* v. *Magnolia Petroleum Co.*, 309 U.S. 478, 483-84 (1940).

Congressional history shows an intent that the filing of a bankruptcy case should not preclude prosecution of a governmental action designed to provide "consumer protection". H. Rep. No. 95-595, p. 343. Those who deposited grain in the warehouses involved in the present case thereby purchased storage services and were clearly "consumers". If Congress had intended to empower bankruptcy courts to bar state enforcement proceedings designed to protect consumer or proprietary interests, it could have easily said so in the statute. *Davis* v. *Pringle*, 268 U.S. 315, 318 (1925); *United States* v. *Embassy Restaurant, Inc.*, 359 U.S. 29, 32 (1959).

5. There is no basis to impute to Congress an intent to empower the bankruptcy courts to exercise pervasive jurisdiction in a manner that would preclude state enforcement of grain legislation. Congress recognized that the bankruptcy power of the United States may restrict the powers of states, but only to the extent necessary "to prevent or prohibit state action that is contrary to bankruptcy policy". S. Rep. No. 95-598, p. 29. See also, *Perez* v. *Campbell*, 402 U.S. 637, at 649 (1971). No action by Petitioners was contrary to any bankruptcy policy. The 1978 bankruptcy legislation should not have been construed to destroy the enforcement powers of Petitioners.*

6. In essence, the Eighth Circuit ruled that although the debtors owned virtually *none* of the grain, the bankruptcy court nevertheless had jurisdiction to adjudicate the competing claims of third parties and to determine which of them owned the grain. However, there is no indication that Congress intended the 1978 bankruptcy legislation to change in any way the basic principle that the bankruptcy courts were without jurisdiction to adjudicate disputes between third parties, except as essential in a given case to administer the debtor's estate. Jurisdiction over disputes between third parties was thus left to

* Indeed, 28 U.S.C. § 959(b) demonstrates Congressional policy that *state* law should apply to trustees and debtors in the absence of a compelling federal policy to the contrary.

the state courts. *First State Bank and Trust Co.* v. *Sand Springs State Bank*, 528 F.2d 350, 353-54 (10th Cir. 1976); *In re Shirley Duke Associates, Debtor*, 611 F.2d 15, 18 (2d Cir. 1979).

7. In the present case, the Court of Appeals construed 28 U.S.C. § 1471 so as to supersede grain laws that had been in force for decades. No federal interest supports such an expansive reading or excuses the destruction of state enforcement powers. The Missouri statutes reflect important state policies designed to maintain the integrity of a major segment of the agricultural industry. In the absence of a federal interest, there should be no different outcome to a controversy "simply because an interested party is involved in a bankruptcy proceeding". *Butner* v. *United States*, 440 U.S. 48, 54-55 (1979). Despite this principle, the bankruptcy proceedings involved here have already operated to deprive the grain owners of their property for one year and raise serious questions as to whether state grain laws afford any protection to grain owners upon a warehouseman's bankruptcy.

CONCLUSION

For the foregoing reasons, the Petitioners respectfully request that this Court issue a writ of certiorari to the Court of Appeals for the Eighth Circuit and reverse that Court's judgment.

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